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Purchasing Index Rebounds to 52.6%

New Orders and Production Expand

Prices Still Lower

Analysis by the Business Survey Committee; chairman, Robert J. Bretz, C.P.M., director of purchasing and distribution, Pitney Bowes, Inc.

The *Report on Business* is published monthly by the National Association of Purchasing Management, based on data compiled from replies to questions asked of purchasing managers in some 250 industrial companies. Membership of the Business Survey Committee is diversified geographically, based on value added by state, and by Standard Industrial Classification category, based on each industry's contribution to national income.

August Report

What's happening with the economy? In August, it strengthened considerably say the nation's purchasing managers in their latest **Report on Business.** The Purchasing Managers' Composite Index rose to 52.6%, after falling to 46.7% in July from 49.6% in June. Production rebounded in August from the low levels of July as many plants returned from planned maintenance and vacation shutdowns. New orders also improved substantially. Inventories continued to decline but at a lower rate than the past two months. Employment remained at about the same depressed levels as June and July. Price increases were moderate in August, the twentieth month in the last twenty-one in which purchasers reported paying the same or lower prices.

"The disturbing downtrend in the three of the last four months reversed direction again in August as the economy returned to an expanding phase, however, there has never been a period when the economy has seemed so erratic," said Robert J. Bretz, C.P.M., chairman of the National Association of Purchasing Management's Business Survey Committee and director of purchasing and distribution, Pitney Bowes, Inc.

The **Purchasing Managers' Composite Index** rose sharply to 52.6% from 46.7% in July and 49.6% in June. August is the fifth month in 1986 in which this leading indicator has registered over 50%. A reading above 50% generally indicates that the economy is in an expanding phase: below 50%, that the economy is generally declining. The index is based on analysis by the U.S. Department of Commerce. Except for this index, the information in this report is not seasonally adjusted.

Net Difference

In each category measured, this report shows a net difference. It is the difference between the number of responses in the positive direction (higher, better, faster) and the negative direction (lower, worse, slower). Analysis of the month-to-month difference compares the rate of change.

Employment

Employment declined again in August as more than twice as many members reported lower employment (23%) compared to higher (11%). This is the twenty-third consecutive month that more members have reported lower rather than higher employment.

Employment %	Higher	Same	Lower	Net Differ.
August	11	66	23	−12
July	10	67	23	−13
June	11	67	22	−11

Buying Policy

In August, lead times for production materials expanded only slightly, as 60% of members reported lead times of 30 days or less compared to 58% in June and July. In the capital expenditure category, 58% reported lead times of six months or longer, up from 51% in July and the most since March 1985 (also 58%). Generally, increased lead times signal increased buying activity. Lead times for maintenance, repair and operating (MRO) supplies remained essentially unchanged except for a slight increase in those reporting buying hand-to-mouth, to 45% in August from 42% in July.

Production Materials %	Hand to Mouth	30 Days	60 Days	90 Days	6 Months and Longer
August	15	45	24	11	5
July	18	40	25	10	7
June	18	40	24	12	6
MRO Supplies %					
August	45	42	6	7	0
July	42	46	6	5	1
June	45	43	7	4	1
Capital Expenditures %					
August	10	4	10	18	58
July	12	8	7	22	51
June	14	6	7	17	56

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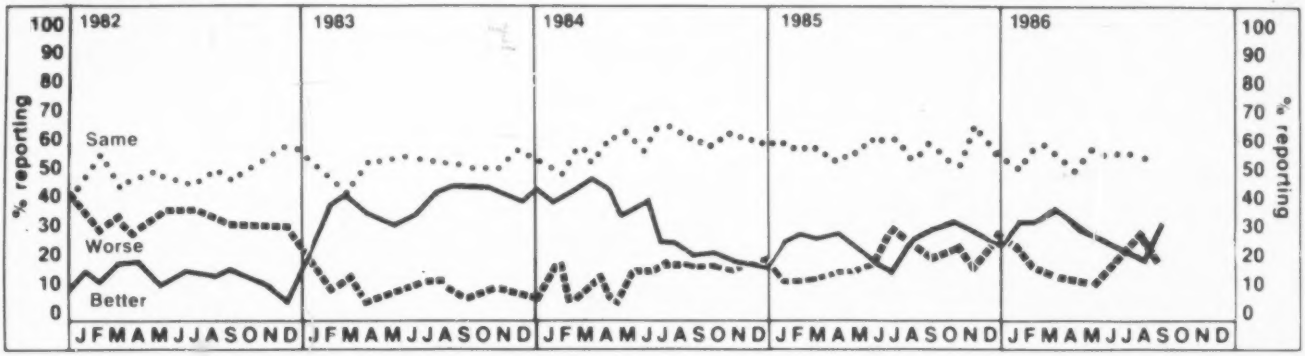
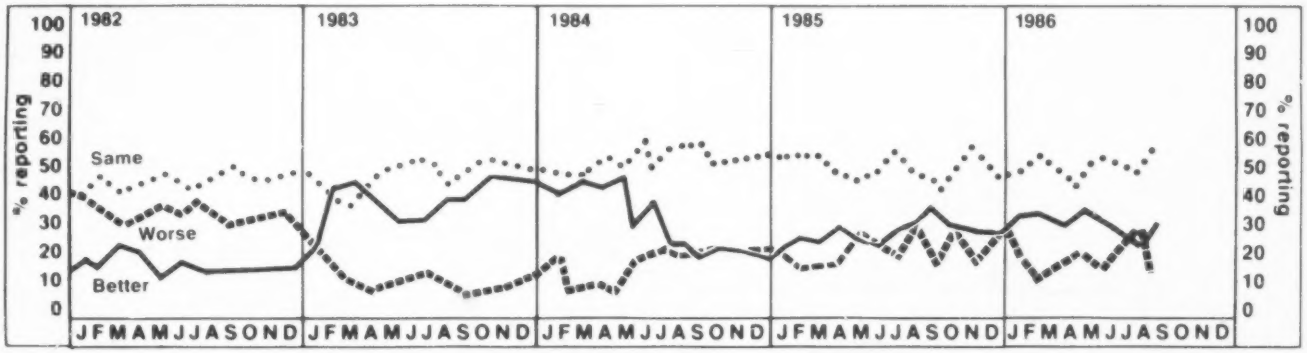
Production



Production improved substantially in August from July's low levels. In a large part, this can be attributed to the reopening of many plants that were closed in July for maintenance and/or employee vacations. Of the 49% of members reporting a summer shutdown, 69% indicated it would occur in July and 22% said August.

Production %	Better	Same	Worse	Net
August	27	54	19	+ 8
July	17	55	28	−11
June	25	55	20	+ 5

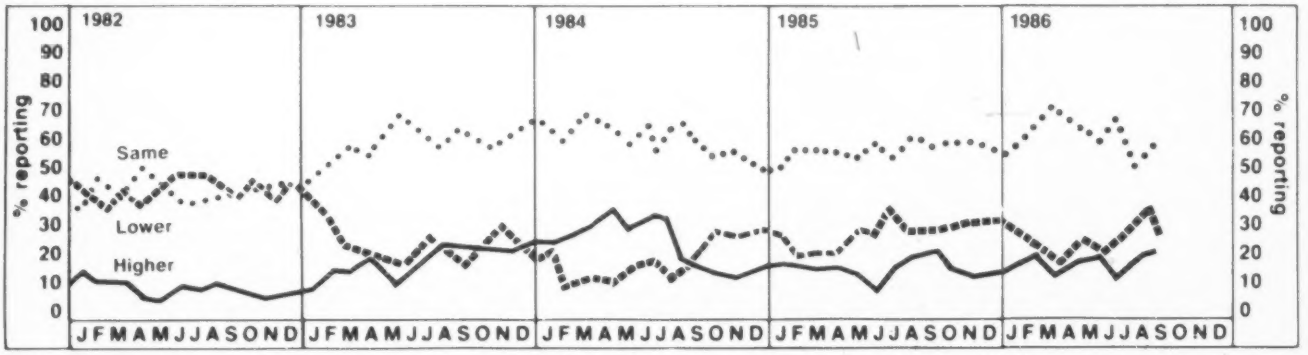
New Orders



New orders expanded significantly in August after declining in July. Almost twice as many members reported better new orders (28%) than worse (15%). This strong increase in new orders suggests a healthy production level for the next thirty to sixy days and is a dramatic turnaround from last month.

New Orders %	Better	Same	Worse	Net
August	28	57	15	+13
July	23	52	25	− 2
June	27	54	19	+ 8

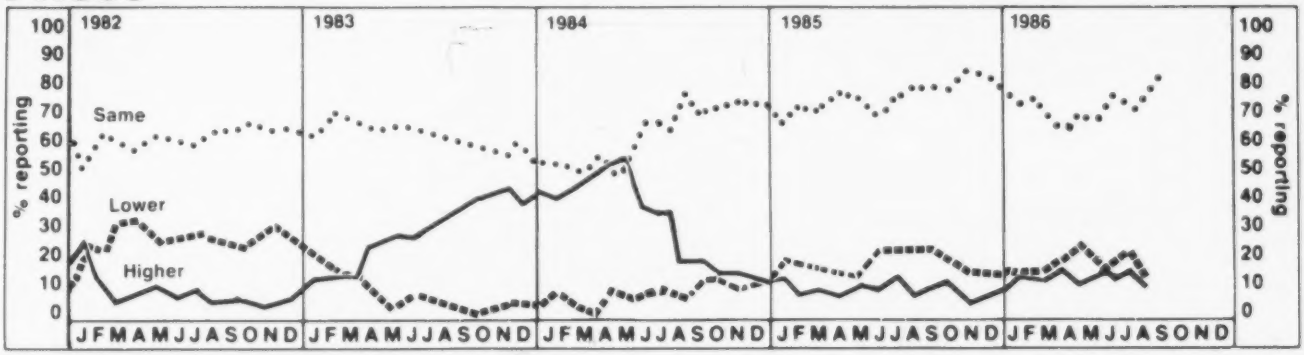
Inventories



Net inventory levels continued to decline in August. For the 24th consecutive month more members have reported lower inventories compared to higher. However, the rate of decline is lower than in the past two months.

Inventories %	Higher	Same	Lower	Net
August	18	58	24	− 6
July	17	50	33	−16
June	12	64	24	−12

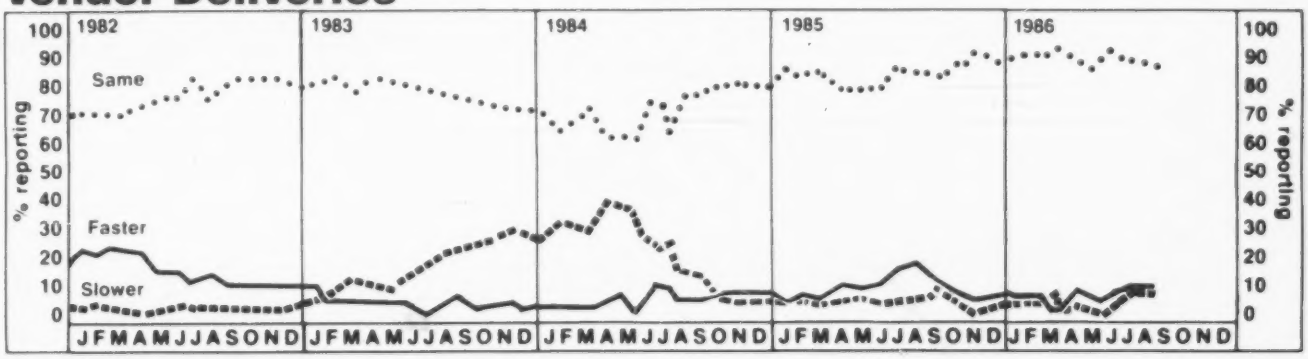
Prices



More members reported lower prices (10%) in August than higher (9%). Out of the past 21 months, only in June 1986 did more purchasers indicate paying higher rather than lower prices.

Prices %	Higher	Same	Lower	Net
August	9	81	10	– 1
July	13	72	15	– 2
June	12	78	10	+ 2

Vendor Deliveries



The speed of vendor deliveries improved slightly in August. Generally this is an indication that vendors are not constrained by production capacity limitations and are able to meet most shipping requirements of purchasers.

Vendor Deliveries %	Faster	Same	Slower	Net
August	7	87	6	+ 1
July	6	88	6	0
June	7	89	4	+ 3

Specific Commodity Changes

For the fifth time in six months, titanium dioxide was reported in short supply. However, this is the only item reported in short supply in the past 19 months. Many paper and paper-related items were reported higher in price in August. Corrugated shipping cartons were reported up in price for the fifth consecutive month and printing paper for the second consecutive month. Kraft linerboard and folding cartons were newcomers to the list of higher-priced commodities. Price decreases continue to be reported for fuel oil (the eighth consecutive month), diesel fuel, gasoline, and methanol (all three for the second consecutive month). Cotton fabric and vegetable oils were two new additions to the list of items reported lower in price in August.

UP in Price: Corrugated shipping containers, kraft linerboard (used in making corrugated shipping containers), folding cartons, printing paper

DOWN in Price: Fuel oil, diesel fuel, gasoline, methanol (a work horse chemical), caustic soda (used heavily in petroleum refining and paper making), cotton fabric, and vegetable oils (used in prepared foods)

In SHORT Supply: Titanium dioxide (a lead-free pigment used heavily as a whitener in coatings and other industrial applications)

The National Association of Purchasing Management's *Report on Business* records the actual changes and rates of change in five important categories of data: production, new orders, employment, inventories and vendor deliveries. These five components, as reported, are not adjusted to compensate for seasonal variations.

Economists have devised a variety of formulas to compensate data for seasonal variations. N.A.P.M. cooperates with the U.S. Department of Commerce, which prepares the monthly Purchasing Managers' Composite Index for publication by N.A.P.M. The Department of Commerce adjusts the five above-mentioned components of the *Report on Business*, applies various weights to each and combines them into a single index number. The Composite Index is based on analysis by the U.S. Department of Commerce, and is the only part of the report adjusted for seasonal variations.

Note: The next issue of the *Report on Business* will be available Oct. 6, 1986.

Commodity Reports

Energy

Prepared by the N.A.P.M. Energy Committee; chairman, Howard T. Perley, C.P.M., International Paper Company, New York, NY.

Crude Oil, Distillates, and Gasoline

OPEC will continue its attempts to establish and maintain crude oil production ceilings. Market expectations of its success will result in wide pricing swings. Therefore, volatile crude oil prices should be expected over the next few years with spot prices ranging from $6.00 to $18.00 per barrel. It appears that OPEC may agree on a production ceiling which, if observed, will push crude oil prices toward the high end of the range.

Gasoline and No. 2 fuel oil prices are expected to closely follow crude oil price swings, but they will stay well below 1985 levels.

During the next six months, high sulfur residual fuel oil prices should range from 70% to 80% of spot crude oil prices.

Natural Gas

Prices charged by local utilities have not dropped as much as crude oil prices because of the interstate pipeline suppliers' long-term price commitments to gas producers. Nevertheless, utilities' gas prices will continue to decline over the next year or two.

However, spot market prices of gas purchased by end-users directly from producers have already dropped sharply, resulting in big savings if pipeline transportation can be obtained. Some interstate pipelines have agreed to transport, but others have not. Some local gas utilities are also resisting, but several state utility commissions have made transportation mandatory.

Electric Power

Although many southern utilities have set new records for summer demand during abnormally hot days, decreased fuel costs and lower inflation rates are resulting in fewer, smaller-rate increases and some decreases.

Notice

Several vacancies currently exist on N.A.P.M.'s Energy Committee. Members interested in serving, should contact Howard T. Perley, C.P.M., N.A.P.M. Energy Committee chair, International Paper Company, New York, NY (212) 536-5670.

Steel

Prepared by the N.A.P.M. Steel Committee; P.C. Conroy, corporate director of purchasing & transportation, Valmont Industries, Valley, NE.

There is some good news for the steel business, but a lot of bad news! For the sixth consecutive month, the majority of the steel buyers intend to maintain their current levels. There are still 45% who will try to reduce inventory levels in the next six months. Couple this information about inventory levels with: 1) the 81% (exceptionally high) of buyers who see their incoming orders below their most efficient levels of operation; 2) the 72% who see no change in their order backlog over the next three months; and 3) you have a pretty stale demand for steel. These buyers (88%) expect economic activity to remain the same or go down in the next six months.

There is some good news. Since May is the third month since the inception of the steel quotas, the penetration of finished steel products has been at or below the program's 20% goal. Overall, imports should end up being reduced as much as three million tons for 1986, versus the 1985 level. Unfortunately, the bad news is that steel consumption in the U.S. is projected to be down 7% (or roughly seven million tons) from 1985's levels, and 1987 could see as much as an 8% further reduction in demand (down to 80 million tons). This leaves the U.S. steel industry facing continued financial pressure.

Improvement in demand for the second half of 1986 is nowhere in sight, therefore, prices are not likely to increase, at least through the balance of 1986. The industry is now adjusting their forecast for the last half of 1986, and shipments are not expected to exceed 32 million tons. The 1987 projections for the domestic mills are not dropping into the low 60 million ton range.

With the recent LTV bankruptcy bringing the market share held by "reconstituted mills" to 24%, the trend toward reorganizations, mergers, and resurrection of bankrupt mills will continue, keeping the domestic steel companies and their pricing strategies in turmoil.